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# CABINET AFFAIRS STAFFING MEMORANDUM

**Date:** 1/30/84 **Number:** ------------ **Due By:**

**Subject:** Cabinet Council on Economic Affairs Minutes: January 10, 12, and 17

| | Action | FYI |
|---|---|---|
| **ALL CABINET MEMBERS** | ☐ | ☑ |
| Vice President | ☐ | ☐ |
| State | ☐ | ☐ |
| Treasury | ☐ | ☐ |
| Defense | ☐ | ☐ |
| Attorney General | ☐ | ☐ |
| Interior | ☐ | ☐ |
| Agriculture | ☐ | ☐ |
| Commerce | ☐ | ☐ |
| Labor | ☐ | ☐ |
| HHS | ☐ | ☐ |
| HUD | ☐ | ☐ |
| Transportation | ☐ | ☐ |
| Energy | ☐ | ☐ |
| Education | ☐ | ☐ |
| Counsellor | ☐ | ☐ |
| OMB | ☐ | ☐ |
| CIA | ☐ | ☐ |
| UN | ☐ | ☐ |
| USTR | ☐ | ☐ |
| GSA | ☐ | ☐ |
| EPA | ☐ | ☐ |
| OPM | ☐ | ☐ |
| VA | ☐ | ☐ |
| SBA | ☐ | ☐ |

| | Action | FYI |
|---|---|---|
| CEA | ☐ | ☑ |
| CEQ | ☐ | ☐ |
| OSTP | ☐ | ☐ |
| Baker | ☐ | ☑ |
| Deaver | ☐ | ☑ |
| Darman *(For WH Staffing)* | ☑ | ☐ |
| Jenkins | ☐ | ☑ |
| Mc Farlane | ☐ | ☑ |
| Svahn | ☐ | ☑ |
| CCCT/Gunn | ☐ | ☑ |
| CCEA/Porter | ☐ | ☑ |
| CCFA/ | ☐ | ☑ |
| CCHR/Simmons | ☐ | ☑ |
| CCLP/Uhlmann | ☐ | ☑ |
| CCMA/Bledsoe | ☐ | ☑ |
| CCNRE/ | ☐ | ☑ |

**REMARKS:**

Attached for your information are the minutes of the following CCEA meetings:

January 10
January 12
January 17

**RETURN TO:**

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823

☐ Katherine Anderson
☑ Tom Gibson
☐ Don Clarey
☐ Larry Herbolsheimer
Associate Director
Office of Cabinet Affairs
456-2800

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MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

January 10, 1984
8:45 a.m.
Roosevelt Room

Attendees: Messrs: Regan, Baldrige, Donovan, Porter, Wright, Abrams, Burnley, Lighthizer, Moran, Naylor, Niskanen, Wallis, Baroody, Bledsoe, Cicconi, Coy, Gibson, Neal, Rhodes, and McAllister, Ms. Heckler, Ms. Risque, and Ms. Whittlesey.

1. Report of Working Group on the Federal Budget

Donald W. Moran presented the report of the Working Group on the Federal Budget regarding the possibility and usefulness of depreciating capital investments that the Federal Government owns and operates. He noted that because collecting information is costly, the need for and use of the information must be identified before a capital planning system is established. A change in accounting rules without a change in incentives or decision making criteria will not have a significant effect.

Mr. Moran stated that there is a need for improved planning for capital investments owned and operated by the Federal Government. Congress has a short planning horizon, usually of about two years, and a bias against new Federal fixed investment in favor of current spending programs for grants and people. The Executive branch has adjusted its capital investment proposals, recognizing the limitations created by Congress's short term horizon. He noted that the Administration has had some success in assuring full first year funding of capital projects. More progress in multi-year contracting and better scorekeeping to reduce Congressional incentives to claim credit for budgetary savings when underfunding capital investment projects through annual appropriations would be helpful.

Mr. Moran stated that there are several key issues in developing an improved capital planning mechanism:

1. Determining what is to be included in the capital investment plan. Alternative criterion might be the cost of the investment or the type of investment;

2. Establishing standardized rules for data collection. Assets for example can be valued at either historical or current values;

3. Determing the most desirable pricing information or depreciation methods;

4. Identifying the necessary degree of centralized data collection;

5. Establishing the focus of decision making: a top-down process or a decentralized intraagency review.

He presented to the Cabinet Council three approaches for a capital budget for Federally owned and operated investments:

1. Improving the formal public presentation based on standardized data;

2. Utilizing better depreciation data and techniques to ensure better Federal decision making. The Working Group recommended that, should the Council consider this option, a private consulting or accounting firm conduct a feasibility study; or

3. Improving the quality, scope and utilization of the present standard level user charge (SLUC) system to ensure Federal decision making. The General Services Administration (GSA) charges agencies market rates for rents on Federally owned real property. The SLUC system might be expanded to include other capital investments, for example computers and automatic data processing systems.

Mr. Moran suggested that an enhanced SLUC system has a number of advantages: (1) it would prompt trade-offs not only between capital investments but also between capital and non-capital investments; (2) the system could be started up relatively quickly; (3) there is an existing data base to build on; and (4) it offers a means for valuing existing assets. The disadvantages are: (1) SLUC charges are limited to areas under GSA purview; and (2) Congress might alter the SLUC charges.

The Council's discussion focused on several issues, including: the potential for Congressional manipulation of a Federal capital planning process; defining a capital asset; and the need to provide incentives for improved decision making. Secretary Baldrige noted that corporations manage either for cash flow or profit and loss. A company losing money, which is analogous to the Federal Government's deficit position, must manage for cash flow.

The Cabinet Council asked the Working Group to investigate further the potential of the SLUC system for capital investment decision making and management.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

January 12, 1984
2:00 p.m.
Cabinet Room

Attendees: The President, the Vice President, Messrs. Regan, Clark, Block, Pierce, Meese, Brock, Feldstein, Svahn, Porter, Brown, Burnley, Wright, Fuller, Herrington, Speakes, Verstandig, Ballentine, Benjamin, Healey, Wallis, Baroody, Cicconi, Cribb, Gibson, Rhodes, and McAllister; Ms. Heckler, Ms. Whittlesey, Ms. Risque, Ms. Chao, and Ms. Whyche.

1. Controlling Federal Credit Activities

Secretary Regan stated that last June, in an effort to develop policy initiatives for 1984 and a second Reagan Administration, the Cabinet Council on Economic Affairs commissioned thirteen economic policy studies on issues ranging from capital formation to financial deregulation to reaching full employment. The Council is presenting the results of the study on controlling Federal credit activities today, and will present the results of other studies over the coming weeks. Secretary Regan stated that controlling the size of the Federal Government requires restraining not only the growth of on-budget Federal spending, but also the growth of off-budget Federal spending, primarily direct loans, and off-budget Federal loan guarantees. The economic effects of these lending programs are often very similar to direct spending programs.

Mr. Ballentine noted that Federal credit intervention is a key element of many industrial policy proposals, and that the difficulty of controlling Federal credit activities offers an excellent illustration of one of the pitfalls of industrial policy. He stated that there are three types of Federal credit activity: (1) direct loans, both on and off-budget; (2) guaranteed loans; and (3) activities of the government sponsored enterprises, such as the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC).

Over the period 1976-82, on-budget spending increased 100 percent and off-budget spending increased 137 percent. Federal credit is also growing as a percent of total credit activity. In the 1970's the Federal Government raised roughly 13 percent of all credit raised; in the early 1980's the Federal Government's share rose to 20 percent. He noted that approximately 60 percent of households, 50 percent of the farm sector, and 13 percent of businesses receive Federal credit assistance. The subsidy contained in the loan can vary. For example, Rural Electrification Administration loans may have interest rates as low as two percent, while other loans may more closely approximate the Department of the Treasury's borrowing rate.

Mr. Ballentine stated that there are two major reasons for the growth in Federal credit activities:

1. Federal credit is perceived as a free good. Many believe that because direct loans are offered at Treasury's borrowing rates and guaranteed loans do not require any outlays, except in the case of default, there is no cost to Federal lending programs. Mr. Ballentine stated that the economic cost is a less efficient credit market; investments that would otherwise have occurred are crowded out of the market.

2. The Congressional budget process does not subject credit programs to the same scrutiny as on-budget spending programs. Neither direct loan obligations nor guaranteed loan commitments are fully covered by the budget resolution process.

Mr. Ballentine outlined several Cabinet Council recommendations for improving the control of Federal credit activities:

1. Support Congressional efforts to move off-budget lending onto the unified budget. He explained that the official budget deficit would increase by $5 billion to $10 billion, but that the economic deficit would be unchanged.

2. Include Federal direct loan obligations and guaranteed loan commitments in the Congressional budget resolution process.

3. Provide an explicit statement of Administration credit policy by revising OMB Circular A-70. The revision would provide general guidelines for proposing credit programs or evaluating credit program proposals, without necessarily being binding.

   He stated that the Cabinet Council recommends that the revised circular include the following principles:

   -- Require that interest rates on direct loans be related to market interest rates so that the direct loan rates will vary as the market rates does. Any desired subsidy would be stated explicity as a fraction of the market rate;

-- Require those receiving Federal loan guarantees to pay for part or all of the expected Federal default liability on the guaranteed loans;

-- Encourage risk sharing with the private sector by offering less than 100 percent Federal loan guarantees rather than the full guarantee frequently used; and

-- Oppose providing Federal guarantees for Federally tax-exempt obligations.

4. Provide government-wide management guidelines for credit programs, for example establishing criteria for designating loans as being default.

Mr. Healey explained that the Federal Financing Bank (FFB) was created 10 years ago to consolidate agency borrowings, as well as government guaranteed borrowings, from the public. The FFB, with assets of $130 billion, saves the Federal Government in excess of $1 billion a year by borrowing at the lowest possible rates.

The Cabinet Council's discussion focused on several issues; including the desirability of including loan programs in the budget process; the need to identify the administrative and subsidy costs of Federal credit programs; and the importance of better management of Federal credit programs.

2. <u>Monetary Policy</u>

Secretary Regan stated that at the start of 1983, the Federal Reserve substantially exceeded its target M1 growth rate of 4 to 8 percent. In May, the Federal Reserve changed the target growth rate to 5 to 9 percent. Over 1983, M1 expanded at a 9 percent rate. However in the six months ending December 1983, M1 grew at a much slower 3.1 percent annual rate. He stated that the Federal Reserve seems to have loosened policy somewhat in December. The Federal Reserve claims to be within its target range, despite the substantial M1 growth over the periods January to May and May to July. He explained that the Federal Reserve believes the substantial M1 growth is in part a result of financial deregulation and the introduction of Super NOW accounts and money market deposit accounts.

Secretary Regan stated that the explosion in M2 seems to be slowing; for 1983 M2 grew at an 11.3 percent rate, slightly above the 7 to 10 percent target. Over the last six months however M2 growth has slowed to 7 percent. M3 growth exhibits the same phenomenon, but less dramatically than M1 or M2. He explained that economists and the Federal Reserve focus their attention on M1.

Secretary Regan stated that there are two interpretations of the recent M1 data. Milton Friedman believes that because the slow M1 growth of July to November "baked into the cake", a downturn in economic growth is highly likely for the first or second quarter of 1984. An alternative interpretation urges caution in analyzing the M1 data because of the variability of the seasonal adjustment factors. Mr. Ballentine stated that the seasonal adjustment factors used in 1983 differ markedly from the factors used in 1981 and 1982. Secretary Regan stated that the M1 growth will require close attention over the next few months.

Mr. Feldstein stated than that he does not share the concern regarding a possible economic slowdown in the next 3 to 6 months. He noted that M1, M2, and M3 are all currently growing within their target ranges, and that a 1 percent increase in M1 growth is roughly equivalent to $2 billion, which is a typical weekly fluctuation. Mr. Svahn stated that at yesterday's meeting nearly all members of the President Economic Policy Advisory Board were very optimistic regarding 1984.

Secretary Regan stated that the Federal Reserve will announce new target rates in February; many analysts expect the M1 target to be 4 to 8 percent growth. He also stated that in February the Federal Reserve will introduce contemporaneous reserve accounting, which is a tool intended to help improve monetary policy by giving the Federal Reserve a current estimate of the banking system's reserves.

The President noted that if the Federal Reserve had maintained its 4 to 8 percent target of the beginning of 1983, the current money stock would exceed the targeted money stock.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

January 17, 1984
8:45 a.m.
Roosevelt Room

Attendees: Messrs: Regan, Block, Pierce, Porter, Wright, Brown, Benjamin, Egger, Lighthizer, Moran, Niskanen, Olson, Baroody, Cicconi, Courtemanche, Gibson, Rhodes, Verstandig, and McAllister.

1. Tax Refund Offsets

Internal Revenue Service (I.R.S.) Commissioner Roscoe Egger presented the results of an IRS study on the effects of the individual income tax refund offset for delinquent child and spousal payments on taxpayer compliance. The Cabinet Council requested the study to help determine the effectiveness of tax refund offsets as a tool for collecting debts owed the Federal Government. The study compared the behavior of taxpayers who were subject to the tax refund offset, with the behavior of a control group, not subject to the offset, for the 1981 and 1982 tax years. The major findings of the study were:

- Taxpayers who were offset against in 1981 were twice as likely not to file a return in 1982. Twenty-six percent of taxpayers who were offset against in 1981 did not file a return in 1982;

- Taxpayers who were offset against in 1981 were three times as likely to become delinquent in 1982;

- There was a noticeable decrease in the size of the refund available for offset from 1981 to 1982, when compared with the control group. This decline in the size of the refund can be traced to a decrease in the number of dependents claimed on the tax returns.

- Sixty-six percent of the 1981 refund offset cases also had a refund freeze in 1982, indicating that the offset program has not affected the pattern of non-payment.

- Although the number of cases referred to the I.R.S. increased from 547,000 to 821,000 from 1981 to 1982, the percent of referral cases resulting in an actual refund offset decreased from 51 perent to 39 percent.

- o Although the average refund issued for all individuals increased from $769 to $822 from 1981 to 1982, the average amount of the refund offset for delinquent child support declined from $624 to $526.

Mr. Egger stated that the refund offset program cost the I.R.S. $9.25 million in excess of the cost of processing the delinquent child and spousal support cases. He noted that diverting I.R.S. resources away from potentially greater revenue sources is a major cost.

He stated that the study was conducted over a single year, and is not definite. However, the evidence does not support expanding the program. The refund offset for delinquent child support payments was authorized by the 1981 Omnibus Budget Reconciliation Act, and cannot be changed without legislation. The I.R.S. will continue the study for another year.

The Cabinet Council discussion focused on a number of issues including the effectiveness of the refund offset in collecting child and spousal support payments. Mr. Egger noted that in 1981, claims for child and spousal support were approximately $2.1 billion; the I.R.S. raised $166 million. Of the 265,000 cases with a refund offset, the delinquent amount was satisfied in full in only 1,300 cases. The refunds offsets are returned either to the States as offsets against State welfare payments or to the parent.

Mr. Wright stated that OMB agreed the program should not be expanded at this time. However, he suggested that the test was flawed because the control group, while having the same tax reporting characteristics, does not share the lack of legal or moral obligation which characterized the offset group.

The Cabinet Council agreed to compare the efficiency of the refund offset with other Federal programs aimed at child support enforcement. The Council noted that most difficult child and spousal support payment cases are referred to the I.R.S.

2. Effects of a Line Item Veto on Government Spending

Council of Economic Advisers Member William Niskanen reviewed a paper arguing that caution should be used in making claims for the line item veto. He noted that evidence from the States indicates that:

1. Total general expenditures per capita are somewhat higher in States where the Governor has line item veto authority.

This remains true even after controlling for the major economic and demographic conditions that affect the per capita distribution of spending among the States; and

2. Line item veto authority appears to affect the composition of spending. States where the Governor has line item veto authority appear to have somewhat higher spending per capital for education and highways, about the same spending for welfare and education, and possibly lower spending for all other activities.

He stated that he supports the concept of a Presidential line item veto authority because of its potential effects on the composition of Federal spending. He noted that Congress has approved line item veto authority for the Governors of U.S. territories including Puerto Rico and Guam.